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In the Supreme Court of the United States

OCTOBER TERM, 1989

VIRGINIA BANKSHARES, INC., ET AL., PETITIONERS,

v.

DORIS I. SANDBERG, RESPONDENT.

FIRST AMERICAN BANKSHARES, INC., ET AL., PETITIONERS,

v.

PAUL H. WEINSTEIN, ET AL., RESPONDENTS.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

As every Supreme Court practitioner knows, the first resort of a brief in opposition to certiorari is to argue that the ruling below is "fact-bound" and for that reason affords no opportunity to resolve an important legal issue; and the second line of defense is to assert that the issues raised have been waived. Respondents prove that they are adept in deploying these tactics, serving up a farrago of "facts" (many of them inaccurate or misleading) that are said to support the jury's verdict and adding a liberal dose of (unsubstantiated) waiver claims. But the Court should not be deceived by these tactics: no matter how skillful respondents' advocacy, their effort founders on the decision actually rendered by the court of appeals. As a reading of that decision plainly shows, the misrepresentation and causation rulings relied on by the Fourth Circuit to uphold liability rest squarely on the legal principles presented for review by the petition, the general importance of which respondents barely bother to dispute.

I. THE PROXY STATEMENT

Respondents have tried valiantly to minimize the importance of the Fourth Circuit's ruling on what constitutes an actionable misrepresentation under the federal proxy laws. In the end, however, that cannot be done. To be sure, the jury's verdict rested on facts—as do all jury verdicts and all cases. But petitioners are not challenging any factual determination. Instead, petitioners are challenging, as a matter of law, the Fourth Circuit's holding that proxy solicitations can be deemed fraudulent based on a jury's findings regarding the subjective motivation of members of a board of directors, or based on disagreements about the use of adjectives to describe disclosed facts. The Fourth Circuit's ruling on these legal issues squarely conflicts with holdings of other circuits.

The directors' subjective motivations. The proxy statement sets forth the opinion of the board of directors that

the merger price was fair and also sets forth objective economic facts relevant to a shareholder's decision about whether the price was fair. The court of appeals found this statement to be a misrepresentation not because it was inconsistent with any objective fact but rather because the "jury was certainly justified in believing that *the directors did not believe a merger at $42 per share was in the minority stockholders' interest* but, rather, they voted as they did for other reasons, *e.g.*, retaining their seats on the board." Pet. App. 15a (emphasis added). Indeed, the court below explained that "the entire thrust of Sandberg's case" was that "the Bank's directors were considerably less concerned with the stockholders' interest than with their own." *Ibid.* In light of this unambiguous holding—focusing exclusively on whether the directors concealed their "real" (*ibid.*) subjective motivations—it is astonishing that respondents would argue that the subjective motivation issue is not presented here.

Respondents' reluctance to admit what the Fourth Circuit actually held is understandable, because the decision is so plainly inconsistent with the many cases cited in the petition (at 12-16) and because the practical consequences of the holding are so seriously adverse for *all* corporations that issue proxy statements.[1] Consequently, respondents have conjured up a new version of what the Fourth Circuit held. They now claim that the defect in the proxy statement was not that it falsely reported the directors' reasons for recommending the merger, but that it misrepresented whether the Board ever made a determination about fair price at all. Opp. 15. Hence, they suggest, the court of appeals premised its decision on the objective issue of what the Board actually did, and not the subjective issue of what the directors personally "believed." One need only read the actual opinion to realize how spurious this claim is. The opinion directly refutes respondents' claim that this case is distinguishable from the many cases holding that the federal securities laws are "not concerned that [defendants] had made a statement that, if the plaintiffs were correct, was misleading since it was not the *true* reason" management took the action in question. *Kademian* v. *Ladish Co.*, 792 F.2d 614, 624 (7th Cir. 1986).

[1] Under the Fourth Circuit's holding, *any* statement of reasons contained in a proxy statement is subject to attack on the theory that the corporate board (or some individuals on the board) harbored unexpressed subjective motivations.

There is little doubt why the Fourth Circuit did *not* accept respondents' newly-asserted theory: it has no support in the record. Both the executive committee and the board of directors of the bank adopted resolutions finding the merger "to be in the best interests of [the] Bank's shareholders." J.A. 1178, 1188. There is no question, moreover, that the executive committee insisted on hearing KBW's financial analysis of the fairness of the price. J.A. 788, 989, 1016. Respondents, of course, have continuously claimed that the directors were not *really* concerned about these matters, and that they were *really* acting for different reasons. Pet. App. 15a-16a. But that claim involves the precise sort of inquiry into the directors' subjective motivation that respondents would have this Court believe is not at issue in this case.

The "independence" of KBW. The Fourth Circuit also held that the proxy statement was false because it described KBW as an "independent" investment banking firm. Pet. App. 16a. As we explained in the petition, this decision perverts the federal securities laws because it bases liability under Section 14(a) on characterizations of fully disclosed facts. Thus, respondents repeatedly point out that KBW was hired by FABI, that it would receive extra compensation upon the merger's consummation, and that it was aware of the price range FABI was considering, but *all of these facts were revealed in the proxy statement*, and the Fourth Circuit never identified any item that should have been, but was

not, disclosed.[2] Beyond this, none of these facts draws into question the truthfulness of the description of this concededly unaffiliated investment banking firm as "independent."

Perhaps not surprisingly, respondents make *no* effort to defend this indefensible ruling. Instead, respondents invent and defend a holding that the court of appeals never made—that the proxy statement was materially false because it misrepresented that "KBW acted independently" or made an "independent determination" (Opp. 16, 17) that the price FABI wanted to pay was fair to minority shareholders. But the proxy statement did *not* say,

[2] Respondents' factual recitation also ignores the ground for liability in this case: this case concerns the adequacy of a proxy statement—not the fairness of the merger or the faithfulness of performance of fiduciary duty. In light of the fact that the court of appeals' opinion poses relatively pure legal issues, it is unnecessary for us to canvass the many distortions of the facts that respondents have introduced in their brief in opposition. But two particularly egregious examples merit response.

First, respondents assert that a memorandum by FABI's treasurer showed that the acquisition would be profitable even "if FABI paid $61 a share." Opp. 2. The document in question actually shows that if FABI paid $61 a share it would be investing $45 million in order to obtain an increased net income of just $299,000 a year (a return of less than 1%). J.A. 1169. As the expert from KBW testified, "[i]f I were to ask any client of ours to invest $45 million for only a $300,000 return, I would be invited out the door." J.A. 984.

Second, respondents claim that the "[d]irectors admitted at trial that the reason the board approved the merger was that the directors thought they had no choice and would be removed from the Bank's Board by FABI if they did not." Opp. 5. But the very pages of the Joint Appendix that respondents cite for this proposition contain the directors' testimony that they were deeply concerned about the fairness of the transaction. See J.A. 863 ("after deliberating on it, I felt it was probably in the best interests of all parties involved. The minority stockholders as well as the majority stockholders . . ."); *id.* at 852 ("Number one was the Keefe, Bruyette report. Number two, when they came to the meeting, I asked them questions. . . . I was satisfied with the answers they gave, and as I stated earlier, I was influenced by the fact that people did not buy the stock at $30 a share earlier.").

as respondents repeatedly assert, that KBW "made an independent determination" of fairness to minority shareholders. To the contrary, *the proxy statement made crystal clear that KBW rendered its evaluation on the basis of information provided by FABI and that KBW "did not attempt to verify independently any such information."* Pet. App. 54a.

Respondents' inability to justify the Fourth Circuit's decision, and their need to dream up an alternative rationale with no support in the record, is the best possible evidence that review by this Court is appropriate and necessary. The court of appeals' condemnation of this proxy statement is in direct conflict with a long line of cases holding that Section 14(a) deals with facts—not characterizations. See Pet. 17-19. Corporate directors should not be subjected to substantial risk of multi-million dollar liabilities based on a jury's disagreement with the directors' choice of words.[3]

II. CAUSATION

The Fourth Circuit could not have been clearer in its holding that a private cause of action can be maintained under Section 14(a) even though the votes of the minority shareholders are unnecessary to the proposed trans-

[3] There is no substance to respondents' claim that this Court's consideration of these federal issues would have little practical effect on the judgments below. As petitioners have explained, their liability on the federal count now amounts to $3.3 million, whereas their liability on the state law count is limited to $2.3 million. See Pet. 7, 9 n.5. Moreover, the liability on the federal count might be transformed on remand into a federal judgment in excess of $13 million. By contrast, the $2.3 million cap on state law liability will remain in effect no matter how large the class, and no matter how many members might opt out and commence independent proceedings under state law. See A. Goolsby, *Virginia Corporation Law & Practice* 125 n.7 (1989) ("The statute addresses the damages arising out of a single transaction or course of conduct."). Finally, the corporate defendants were not found liable on the state law count at all. In short, the petition for certiorari is hardly an academic exercise.

action. The court of appeals first recognized that footnote 7 of *Mills* v. *Electric Auto-Lite Co.* "left open the question of 'whether causation could be shown where management controls a sufficient number of shares to approve the transaction without any votes from the minority.'" Pet. App. 13a. The court then proceeded to "adopt the reasoning" of *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), and to hold that liability may be established "even when the minority's voting strength is insufficient to halt a merger." Pet. App. 14a. Given the Fourth Circuit's explicit holding on the *Mills* issue, respondents' claim that the issue was not adequately preserved in the lower courts is simply preposterous. This Court consistently has held that "[t]here can be no question as to the proper presentation" of a claim when the lower court has actually passed on it. *Raley* v. *Ohio*, 360 U.S. 423, 436-437 (1959). This principle has been recognized in cases on review from federal courts and even in cases arising from state courts, where the preservation question takes on jurisdictional significance. See *Mills* v. *Maryland*, 486 U.S. 367, 371 n.3 (1988) (state court); *Orr* v. *Orr*, 440 U.S. 268, 274-275 (1979) (state court); *On Lee* v. *United States*, 343 U.S. 747, 749-750 n.3 (1952) (federal court).

Moreover, there is no basis for respondents' argument that the causation claim was waived. In the district court, petitioners repeatedly objected to the court's ruling that a Section 14(a) case could go forward even though the minority shareholders lacked the votes needed to defeat the merger. For example, petitioners objected to instructions that allowed the jury to find that the proxy statement was an "essential link" simply because it was required by Virginia law. J.A. 1120. Counsel objected on the ground that "the court has wrongly, we believe, decided the issue of law left open by footnote 7 of the *Mills* decision." J.A. 1133. See also Bankshares' Summ. Judg. Br. at 50 (arguing that the *Schlick* "rule makes no sense, and it particularly makes no sense in this

case"); Bankshares' J.N.O.V. Br. at 4 (arguing that given the 85% share held by the majority shareholder, the proxy solicitation "was not an 'essential link' in the *accomplishment* of the merger transaction.") Far from having waived this argument, petitioners raised it at each relevant stage of the district court proceeding. Similarly, in their briefs before the court of appeals, petitioners strenuously challenged respondents' ability to demonstrate causation. See Br. of Corp. Defs. at 23-24. Of course, the best evidence that this issue was preserved and is properly before the Court is the Fourth Circuit's explicit holding on the issue.[4]

Aside from asserting that the causation argument has been waived, respondents try to portray it as another fact-bound application of settled legal principles. But this issue of statutory construction does not turn on the particular facts of this case. The question presented is whether the lower courts should be permitted to greatly expand the implied cause of action under Section 14(a) to allow recovery by plaintiffs whose *votes* concededly could not have affected the outcome of the ballot, and, if

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[4] Respondents' claim (Opp. 18) that petitioners conceded that the proxy statement was an essential link is inaccurate. Petitioners acknowledged that the proxy statement was necessary under Virginia law (see J.A. 343, 820), but they never conceded—indeed (as explained in text) they repeatedly challenged—respondents' contention that the proxy statement could satisfy the "essential link" requirement of *Mills*. The fact that petitioners asked for an instruction informing the jury that it could find in favor of respondents only if the proxy was an "essential link" does not support respondents' waiver claim. Opp. 20. The issue went to the jury only because the trial court refused to settle it as a matter of law, as petitioners repeatedly requested.

Respondents also trumpet the irrelevant assertion that they "established the causal connection between the *merger* and their loss" (Opp. 22; emphasis added). What is required, however, is proof of a causal connection between the *Section 14(a) violation* and the plaintiffs' injury.

so, how these more tenuous causation theories can be established. See Pet. 19-27.[5]

This question of non-voting causation is precisely the issue that the Court left open in *Mills*; it is directly related to the non-voting causation issue that the Court addressed in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 474 n.14 (1977); and it has caused substantial confusion in the lower courts ever since. See Pet. 24-27. There is nothing fact-specific about these issues, and there is a pressing need for this Court's review.[6]

III. THE GENERAL VERDICT

Respondents make no serious attempt to defend the Fourth Circuit's suggestion that petitioners somehow waived their claim that the jury's verdict can be upheld only if the reviewing court is confident that it rests on a sustainable theory. See Pet. 29 n.12. Instead of defending the Fourth Circuit's inexplicable discussion of waiver, respondents claim that it is not appropriate to grant certiorari to decide whether the Fourth Circuit erred in

[5] Respondents hint mysteriously that there are a variety of ways in which a plaintiff can prove causation in a non-voting case. See Opp. 23-24. But even if some non-voting theory of causation—such as ability to obtain a state-court injunction against the proposed transaction—were supportable, the more attenuated theories that respondents suggest, such as use of adverse publicity to discourage a proposed merger, are far too speculative and conjectural to support liability. In any event, respondents did not demonstrate causation under *any* theory in the courts below, choosing instead to rely on the bare fact that the proxy statement was required by Virginia law. Opp. 22.

[6] Petitioners agree that there might be a difference between non-voting causation in a Section 14(a) and a Section 10(b) case. Indeed, petitioners argue that precisely because of Section 14(a)'s unique focus on voting, there should be no private cause of action for non-voting injuries. But if the Court were to reject that argument, then the causation element of Section 14(a) and Section 10(b) would raise identical issues. This Court's causation rulings under Sections 10(b) and 14(a) repeatedly rely on the same authorities and principles. See, *e.g.*, *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231-232 (1988); see also Pet. 26 nn.8-9.

deeming this claim waived. But no one has ever suggested that "waiver" is independently worthy of review. And no one should be heard to suggest that this clearly indefensible reference to waiver is sufficient to bar the Court from reviewing an important and recurring issue that is otherwise "certworthy."

A recent decision of the Ninth Circuit reveals just how divided the lower courts are on the question of reviewing general verdicts. In *Kern* v. *Levolor Lorentzen, Inc.*, No. 87-6689 (9th Cir. March 9, 1990), the court upheld a general jury verdict that might have rested on a claim that was not factually supported. In order to do so, however, the court carefully examined a variety of factors in order to assure itself that the jury in fact rested its decision on a sustainable allegation. Slip op. at 2539-2540. Judge Kozinski dissented, arguing that the approach that the panel took ran counter to at least four Supreme Court decisions, and that the court could not sustain the jury verdict unless it was adequately supported by *all* of the bases for liability placed before the jury. Notwithstanding these Supreme Court decisions, Judge Kozinski was able to discern at least four different approaches that the courts of appeals have taken in reviewing general verdicts. *Id.* at 2567-2571. As Judge Kozinski pertinently observed: "When the Supreme Court speaks consistently and repeatedly on an issue, the inferior federal courts are bound to follow suit." *Id* at 2567.

Respondents have referred to a number of circuits that may have adopted the unworkable fact/law dichotomy that the Fourth Circuit invoked here. But they have ignored the many other circuits that have rejected this dichotomy, and have refused to acknowledge that the Fourth Circuit's approach is in direct conflict with these rulings.[7] Nor do they address petitioners' contention that

[7] See, *e.g.*, *Olney Savings & Loan Assoc.* v. *Trinity Banc Savings Assoc.*, 885 F.2d 266, 270-271 (5th Cir. 1989) (11 factual allegations of fraud); *Murphy* v. *United States*, 653 F.2d 637, 646 (D.C. Cir. 1981) (three factual allegations of negligence); *Avins* v. *White*, 627

the allegations in this case would fall on the law side of any reasonable fact/law dichotomy. The widespread confusion about the proper mode of review of general verdicts is of more than academic interest, as it goes to the fundamental question of meaningful appellate review. This Court should use the present case to restore coherence to this important area of federal law. Granting the petition for certiorari would present the Court with an opportunity to do so in a case that raises additional issues independently worthy of review.

CONCLUSION

The petition for a writ of certiorari should be granted.[8]

Respectfully submitted.

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F.2d 637, 646 (3d Cir. 1980) (three factual allegations of defamatory statements).

[8] The bank in this case filed its proxy statement pursuant to regulations of the FDIC, and the merger at issue was approved by the FDIC. Pet. App. 52a. As the amicus brief filed by the American Bankers Association explains, the extravagant claims of liability sustained in this case are contrary to traditional regulatory policies advocated by the FDIC in past securities cases affecting federally regulated and insured banks. See U.S. Am. Br., *Marine Bank* v. *Weaver*, No. 80-1562, at pp. 24-26. Accordingly, if the Court is in doubt about whether to grant the petition, it may wish to obtain the views of the United States.